

## Message Text

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PAGE 01 BUENOS 04631 112209Z

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ACTION ARA-10

INFO OCT-01 ISO-00 COME-00 EB-07 AID-05 CIAE-00 FRB-03

INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03 SP-02

CIEP-01 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04

CEA-01 L-03 H-02 PA-01 USIE-00 PRS-01 AGR-05 SSO-00

NSCE-00 INRE-00 /090 W  
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FM AMEMBASSY BUENOS AIRES

TO SECSTATE WASHDC IMMEDIATE 1830

INFO AMEMBASSY ASUNCION

AMEMBASSY BRASILIA

AMEMBASSY LA PAZ

AMEMBASSY MONTEVIDEO

AMEMBASSY SANTIAGO

C O N F I D E N T I A L BUENOS AIRES 4631

PASS COMMERCE, TREASURY

E. O. 11652: GDS

TAGS: EFIN, EGEN, AR

SUBJECT: ECONOMIC OUTLOOK FOLLOWING WAGE SETTLEMENT

REF: BUENOS AIRES 4610

SUMMARY: ECONOMIC OUTLOOK PESSIMISTIC FOLLOWING PARITARIA WAGE SETTLEMENT AND OTHER RECENT DEVELOPMENTS. COMPANIES ARE CONCERNED OVER SIZE OF WAGE INCREASES, BUT EVEN MORE WORRIED ABOUT GENERAL ECONOMIC SITUATION AND GOA INABILITY IMPLEMENT COHERENT ECONOMIC POLICY. LIQUIDITY SHORTAGE WILL BE SIGNIFICANT IMMEDIATE PROBLEM AS COMPANIES TRY TO FINANCE SHARP LABOR COST INCREASES. BALANCE OF PAYMENTS SITUATION NOW MORE SERIOUS THAN EVER AND FOREIGN EXCHANGE RESERVES SCRAPING BOTTOM. WITH RECENT WAGE INCREASES, INFLATION DURING 1975 COULD  
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PAGE 02 BUENOS 04631 112209Z

REACH 200 PERCENT--HIGHEST IN RECENT ARGENTINE HISTORY. TREASURY

DEFICIT MAY BE FOUR TIMES LAST YEAR'S SUBSTANTIAL FIGURE. BELIEVE GOA LIKELY STICK WITH CURRENT ECONOMIC LIBERALIZATION PROGRAM DESPITE STRONG OPPOSITION LABOR AND OTHER POWERFUL GROUPS. END SUMMARY.

1. REACTION--REACTION IN ECONOMIC CIRCLES TO PARITARIA WAGE SETTLEMENT AND RELATED DEVELOPMENTS IS ONE OF PESSIMISM. RODRIGO "BLEW IT" AND "LOST OPPORTUNITY" ARE AMONG COMMON SENTIMENTS EXPRESSED. GENERAL CONSENSUS IS THAT SITUATION NOW WORSE THAN MONTH AGO. SHARP LABOR COST INCREASES NATURALLY CAUSING CONCERN. HOWEVER, WHAT BOTHERS MOST COMPANIES IS OVERALL CHAOTIC CONDITION OF ECONOMY AND FACT THAT POLITICAL INCOHERENCE CONTINUING MAKE RESPONSIBLE ECONOMIC POLICY FORMULATION IMPOSSIBLE. MOST OBSERVERS BELIEVE POLITICAL SITUATION STILL UNDEFINED AND EXPECT CONTINUATION ECONOMIC CONFUSION UNTIL IT IS DEFINED.

2. LIQUIDITY PROBLEM - SIGNIFICANT LIQUIDITY SQUEEZE WILL BE ONE IMPORTANT CONSEQUENCE SHARP WAGE INCREASES. COMPANIES WILL HAVE TROUBLE PAYING SO MUCH SO QUICKLY. THERE ARE EVEN DIRE PREDICTIONS, PROBABLY EXAGGERATED, THAT ENTERPRISES IN WEAKER FINANCIAL CONDITION MAY BE FORCED TO CLOSE. TO FINANCE WAGE PAYMENTS, CENTRAL BANK WILL PROBABLY EXPAND CREDIT TO PRIVATE SECTOR WHICH HAS BEEN TIGHT THIS YEAR. THIS WILL RAISE MONEY SUPPLY AND CREATE MORE INFLATION.

3. BALANCE OF PAYMENTS--BALANCE OF PAYMENTS SITUATION NOW MORE SERIOUS THAN EVER. CURRENT ACCOUNT DEFICIT FOR YEAR LIKELY EXCEED \$500 MILLION. EXPORTS ARE QUITE STAGNANT AND EXPORTERS ALREADY REQUESTING FURTHER DEVALUATION WHICH MAY COME VERY SOON. SOME COMMERCIAL BANKS HAVE GREATLY REDUCED IMPORT OR EXPORT BUSINESS, AND REPORT THEIR FOREIGN DEPARTMENTS WORKING AT ABOUT HALF NORMAL VOLUME. CURRENT ACCOUNT DEFICIT, AND HEAVY DEBT REPAYMENTS DUE COMING MONTHS, UNDERSCORE GOA NEED FOR CAPITAL INFLOW. GROSS EXCHANGE RESERVES NOW SCRAPING BOTTOM. MINISTER RODRIGO REPORTED END MAY GROSS FOREIGN EXCHANGE RESERVES AT \$700 MILLION, BUT FREE RESERVES TO PAY DEBT MAY BE LESS THAN \$200 MILLION. CENTRAL BANK HAS BEEN ROLLING OVER AS MUCH DEBT AS POSSIBLE, ENCOURAGING CAPITAL INFLOWS VIA SWAP TRANSACTIONS, AND USING OTHER DEVICES

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PAGE 03 BUENOS 04631 112209Z

IN ORDER MAKE ENDS MEET, BUT SITUATION HAS REACHED EXTREMELY CRITICAL POINT.

4. WAGE-PRICE SPIRAL--RECENT WAGE SETTLEMENT WILL SET OFF FURTHER WAGE-PRICE SPIRAL IN OPINION MOST OBSERVERS. OUTLOOK IS FOR 20-30 PERCENT INFLATION OVER NEXT SEVERAL MONTHS. INFLATION FOR YEAR COULD EASILY REACH 200 PERCENT, HIGHEST IN RECENT ARGENTINE HISTORY. SOCIAL REPERCUSSIONS OF THIS LEVEL INFLATION OMINOUS.

MOST OBSERVERS BELIEVE FURTHER WAGE ADJUSTMENTS WILL BE REQUIRED SOON.

5. TREASURY DEFICIT--TREASURY SITUATION ALSO VERY GRAVE. FISCAL DEFICIT NOW LIKELY REACH FOUR TIMES LAST YEARS SUBSTANTIAL LEVEL. TAX REVENUE PROBABLY WILL NOT EVEN COVER 50 PERCENT TOTAL TREASURY EXPENDITURES. MANY STATE ENTITIES APPROVED LARGE WAGE HIKES WHICH WILL PROBABLY LEAD TO ANOTHER ROUND OF PUBLIC SERVICE TARIFF INCREASES. PUBLIC SECTOR INVESTMENT PROGRAM WILL BE ADVERSELY AFFECTED BY CURRENT COST INCREASES AND EXTERNAL FINANCING WILL BE EVEN MORE IMPORTANT.

6. OUTLOOK--AT PRESENT WRITING, GOA STILL MAINTAINING MINISTER RODRIGO AND CURRENT ECONOMIC LINE--AT LEAST FOR TIME BEING. AFTER TEMPORARY SETBACK ON WAGE ISSUE, WE BELIEVE GOA WILL SEEK PRESS AHEAD WITH LIBERALIZATION PROGRAM ANYWAY, ALBEIT WITH SOME ADJUSTMENTS AND HOPEFULLY WITH MORE POLITICAL REALISM. CURRENT GOA LINE ON FOREIGN INVESTMENT, COOPERATION WITH FOREIGN CAPITAL, ETC. ALSO EXPECTED TO BE MAINTAINED. RODRIGO'S IMAGE HAS BEEN TARNISHED BY RECENT DEVELOPMENTS, HOWEVER, AND OPPOSITION TO MINISTER AND HIS PROGRAM WILL BE VERY STRONG, ESPECIALLY ON PART OF LABOR AND MORE ORTHODOX PERONISTS. HE MAY NOT LAST LONG. IN PRACTICE, OPPOSITION ECONOMIC LINE IS COALESCING IN FAVOR RETURN TO "CONCERTATION" POLICY, I.E., MORE CONTROLS, PUBLIC INVOLVEMENT IN ECONOMY, ETC. MOST OBSERVERS FORESEE ANOTHER POLITICAL CONFRONTATION IN NEAR FUTURE AND CONTINUED ECONOMIC CONFUSION IN INTERIM.  
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